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Analysis of Business Trends Plus Selected Financial Indicators

Dollar Dog Days

While it may be somewhat premature to mention the lethargy often associated with the "dog days" of summer, it is an apt description of the general behavior of the foreign exchange markets in recent months. Although the dollar experienced a hefty move higher during the first seven weeks of this year—tacking on some ten percent to its external value versus the Deutschemark—since then its steering currents have dissipated and the "greenback" has meandered in a narrow six to eight pfennig trading range, fluctuating in the DM1.59-DM1.67/US$ neighborhood. Nor does any big change appear imminent.

With monetary policies in both the United States and Europe unlikely to be altered as long as the Federal Reserve remains comfortable with the pace of the U.S. business recovery and as long as the Bundesbank remains uncomfortable with Germany's rate of inflation, short-term international interest rate differentials will remain unfriendly toward the dollar. But whereas more attractive yields elsewhere will put a damper on the dollar's upside potential, the downside will also be limited—not only by the darkening economic skies in Europe (Financial Digest—April 6, 1992), but by a mushrooming U.S. trade surplus with the region, which is sorely testing the patience of a growing number of European policymakers who believe that the cheapening of the dollar has gone too far.

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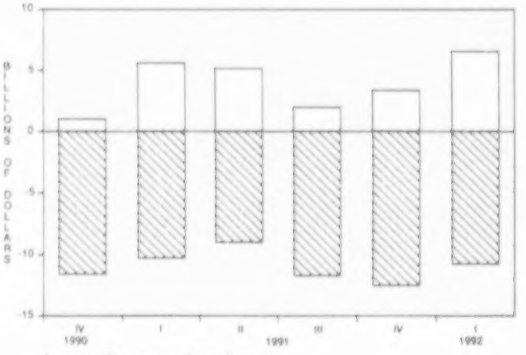
However, notwithstanding the current calm, and the best efforts of the Group of Seven (G-7) industrial countries to keep it that way, the dollar will not be locked into a tight trading range forever. In this instance, forever ends when short-term U.S. interest rates start to rise and European interest rates begin their long-awaited descent. Widespread expectations still abound that the dollar will close the year on a decidedly higher note than where it is today—at least against the currencies of Europe. And, although the timing of the anticipated changes in monetary policies, and the subsequent dollar rally, is uncertain, the logic behind it becomes more credible with the release of every firmer U.S. economic statistic and every downbeat German one.

Take, for example, U.S. business conditions. While dollar enthusiasts have been periodically disappointed at the plodding pace of America's recovery, recent surveys of consumer and business confidence as well as trends in retail sales, industrial output and even payroll employment suggest that the business upturn is spreading. What is more, with debt loads lighter, inventories leaner and interest rates lower, the odds do not favor a repeat of last year's economic performance in which the calendar, interest rates and the dollar all wound down in tandem. As a result, the Federal Reserve has apparently decided not to ease monetary policy further, notwithstanding the virtual absence of inflation pressures and the desultory growth of the M2 money supply.

U.S. TRADE BALANCE WITH WESTERN EUROPE (CLEAR BARS) VS. JAPAN (SHADED BARS)



Source: Commerce Department

Bundesbank Discomfort

While the prospect of quicker U.S. growth fueled the runup of the dollar earlier this year, its future upside potential pivots around the timing and extent of anticipated European interest rate cuts. Although widely expected to take place earlier this year in response to persistent economic lethargy, the edifice of lofty European interest rates is only now starting to crack; in recent weeks, short-term interest rates in both the recession-plagued United Kingdom and stagnation-bound France have been trimmed slightly. However, a more sizeable and sustained descent of European interest rates must await a relaxation of German monetary policy in order to avoid upsetting exchange rate stability within the Exchange Rate Mechanism of the European Monetary System. So far, the Bundesbank has stood fast, citing its discomfort with a rate of inflation approaching five percent, a rapidly expanding money supply and the prospect of excessively generous wage settle-

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ments which would only make the job of controlling inflation that much more difficult.

Several developments are, however, chipping away at the Bundesbank's objections to policy ease. For one thing, Germany's economic malaise will eventually erode existing price pressures; the economy has sputtered for a year and the country's five major research institutes recently stated that this year won't be much better. Although the 4.6 percent rate of consumer price inflation is double what it was two years ago, wholesale price inflation has slowed to less than two percent over the past 12 months. For another, although M3 money growth remains stubbornly quick—and, at a nearly nine percent annualized clip in April, far above the targeted 3½ to 5½ percent range—its behavior is increasingly divorced from economic reality. Rather than reflecting an incipient inflation threat, the strong credit demands which have fueled this growth arise from the downturn-related squeeze on business cash flow and the officially-encouraged investment requirements of eastern Germany. In fact, the same five institutes that noted Germany's deteriorating growth prospects acknowledged precisely this, and urged that the M3 targets be lifted. Finally, the closely-watched wage round has been less than apocalyptic; public sector

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/13/92)	149,859	- 1,904	- 48,072
New York City (5/20/92)	27,100	+ 561	- 4,989
Commercial Paper (5/20/92)	544,444	- 437	- 4,422

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/13/92)	285,762	- 1,632	- 28,887
New York City (5/20/92)	49,230	- 325	- 7,064

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/13/92)	1,008,520	- 1,702	- 38,002
New York City (5/20/92)	161,652	- 1,409	- 11,652

Financial Markets

	Friday 5/29/92	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	3.77%	+ .02	- 1.87
180-Day Bills†	3.94	+ .04	- 1.97
Longest Bills†	4.23	+ .09	- 1.90
Recent Issues:			
5⅛s 5/31/94	5.17	NA	
6⅛s 5/31/97	6.61	NA	
7⅛s 5/15/02	7.33	- .01	
8s 11/15/21	7.83	+ .01	
Municipals:			
Bond Buyer—20 Bond Index* (5/28/92)	6.58%	+ .07	- .39
Blue List Total ($ Million)	$1,445	+ $157	- $ 53
30-Day Visible Supply ($ Million)	$4,429	+ $528	+$1,310
Total	$5,874	+ $685	+$1,257
Corporates:			
Moody's Aa Composite (5/28/92)	8.60%	+ .01	- 1.15
30-Day Visible Supply ($ Million)	$1,529	+ $275	+$1,379
Stocks:			
Dow-Jones Averages:			
Industrials	3,396.88	+ 10.11	+369.38
Transportation	1,370.14	- 6.36	+141.12
Utilities	213.45	+ .57	+ 1.68
65 Stocks	1,197.09	+ .70	+111.42
N.Y.S.E. Composite Index	228.87	+ .67	+ 15.88
N.Y.S.E. Avg. Daily Vol. for Week (000's)	217,399	+ 3,366	+12,784

*34% Taxable equivalent 9.97%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/29/92	Week Ago
Overnight	4.06%	3.94%
1 month	4.00	3.94
3 month	4.06	4.00
6 month	4.19	4.13
1 year	4.69	4.63

FOREIGN EXCHANGE SPOT RATES

New York Opening (5/29/92)	Currency Per U.S. $	Week Ago
Belgium	33.06	33.28
Canada	1.2024	1.1543
France	5.3996	5.4383
Germany	1.6090	1.6185
Italy	1211.28	1218.97
Japan	128.15	129.85
Mexico	3107.01	3097.50
Netherlands	1.8095	1.8214
South Korea	799.17	799.07
Switzerland	1.4565	1.4875
Taiwan	24.67	24.71
U.K.*	1.8258	1.8154

*U.S. $ per U.K. pound

CHEM TRADE-WEIGHTED DOLLAR (5/29/92) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+1.7%	-17.1%

workers settled for a 5.4 percent pay hike—slower than last year's six percent—and private sector settlements are falling in the same ballpark.

Fundamental Flaw

Once the Bundesbank's inflation concerns fade, the door will open for German interest rate cuts and a resumption of the dollar's upswing. If so, any broad-based dollar rally will undoubtedly encompass the yen as well, as Japanese institutions scramble to participate in potentially profitable dollar-buying. Yet, herein lies the rub. Whereas a yawning, and widening U.S. trade surplus with Western Europe lends fundamental justification to an orderly dollar ascent versus the European currencies, the once again widening U.S. trade deficit with Japan does not, and suggests that a similar dollar move versus the yen would be fundamentally flawed (see chart). The red-ink reached nearly $4 billion in March, 11 percent larger than in March 1991, and just about $11 billion in the entire first quarter. And while yen appreciation alone may not remedy the existing trade imbalance, it is fairly obvious that yen depreciation will not help. Since Treasury and Federal Reserve policymakers know this, they will probably be much more inclined to stifle any dollar updraft versus the yen, than against the European currencies.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/27/92	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	278.881	+ 4.193	+28.259
Loans to Depository Inst.	.174	+ .035	- .129
Float	.093	- .210	- .234
Total Reserve Bank Credit	308.008	+ 3.062	+21.462
Treasury Deposits with			
Federal Reserve Banks	5.438	+ .368	+ .794
Currency in Circulation	309.103	+ 1.257	+19.336
Gov'ts held for Foreign Acct.			
by F.R. Banks (End-of-Week)	275.242	- 1.487	+29.103
Member Bank Reserves:	5/27/92		
Total Reserves Held	56.943	- .215	+ 8.466
Excess (Deficiency)	1.488	+ .854	+ .368
Net Free Reserves	1.331	+ .850	+ .451
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (5/18/92)	953.9	+ 11.6	+ 12.2
M2 (5/18/92)	3,468.4	+ 0.3	+ 2.0
M3 (5/18/92)	4,178.6	- 1.7	+ 0.3
Domestic Nonfinancial Debt (4th Q'91)	11,229.1	+ 5.3	+ 4.4

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 5/29/92	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	3.68%	3.82%	4.05%
* Federal Agencies	3.83	3.95	4.25
* Municipal Notes–High Grade (34% Taxable Equivalent)	4.55	4.62	4.85
Negotiable Time CDs			
Chemical	Rates By Arrangement		
* Secondary Market–Prime	4.06	4.15	4.60

‡ Finance Company Paper–Prime

5- 14 days	3.82%
15- 29 days	3.80
30- 59 days	3.83
60- 89 days	3.83
90-179 days	3.86
180-239 days	3.95
240-270 days	3.95

‡ Industrial Paper–Prime

30- 89 days	3.87%
90-120 days	3.90

‡* Bankers' Acceptances

Jun.	3.83%
Jul.	3.83
Aug.	3.84
Sep.	3.88
Oct.	3.92
Nov.	3.96

†Federal Funds Effective Rate 3.75%

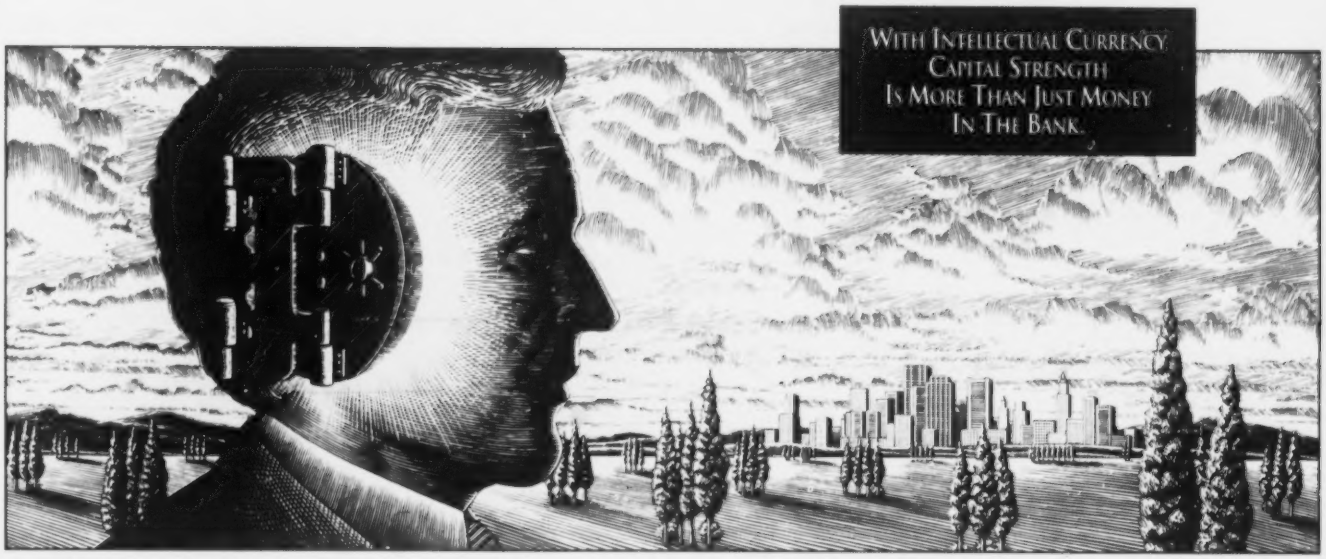
‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross Domestic Product (Current Dollars)*	1st Q'92	$ 5,818r	$ 5,740	$ 5,589
Gross Domestic Product (1987 Dollars)*	1st Q'92	$ 4,897r	$ 4,868	$ 4,824
Percent Change, Annual Rate	1st Q'92	2.4r	0.4	- 2.5
Change in Consumer Prices*	Apr '92	2.4%	6.0%	2.4%
Change in CHEM Cost of Living Index*	Apr '92	9.6%	6.0%	7.2%
Change in Producer Prices*	Apr '92	2.4%	2.4%	2.4%
Civilian Employment (Thousands of Persons) †	Apr '92	117,675	117,348	117,388
Unemployment as % of Civilian Labor Force †	Apr '92	7.2%	7.3%	6.6%
Personal Income*	Mar '92	$ 4,990	$ 4,963	$ 4,781
Leading Indicators Composite Index (1967=100) †	Mar '92	147.9	147.6	141.5
Industrial Production Index (1977=100) †	Apr '92	108.2	107.6	105.5
Net Change in Consumer Installment Credit †	Mar '92	- $ 1.61	- $ 0.47	- $ 0.32
U.S. Merchandise Trade Balance †	Mar '92n	- $ 5.82	- $ 3.29r	- $ 4.07
Plant and Equipment Expenditures*	2nd Q'92	$ 557.5(a)	$ 545.0(a)	$ 524.6
Private Housing Starts (Thousands of Units)*	Apr '92n	1,115	1,344r	978
New Construction Expenditures*	Mar '92	$ 419.9	$ 413.3	$ 401.9
Total Business Inventories †	Mar '92	$ 816.3	$ 813.2	$ 818.5
Total Business Sales †	Mar '92	$ 547.9	$ 545.4	$ 523.4

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.



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